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Raising Domestic Revenue for the MDGs: Why Wait until 2015?

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Financing MDG-based national strategies has focused, so far, on scaling up ODA. Mobilising domestic revenue, by contrast, has been neglected, despite being a better long-term option. There are various reasons: pessimism about raising revenue, a prevalent 'small-state' ideology and a preference for ODA-led solutions.

The development community seems content to emphasise mobilising domestic revenues after 2015. *Is such an oversight justified?* This One Pager believes not. It stresses domestic revenue mobilisation—starting now—as crucial to achieving the MDGs and any longer term development goals.

In order to highlight this issue, we examine trends in revenue mobilisation in a representative sample of 26 low-income countries in sub-Saharan Africa, comparing two periods, 1990-1995 and 2000-2005. The figure captures the major trends in total revenue and its two chief components, tax revenue and nontax revenue.

Total revenue increased by less than two percentage points of GDP, i.e., from 14.1 per cent to 15.9 per cent. This was driven by increases in tax revenue, with no discernable change in nontax revenue. Substantially more could have been achieved. The goal for 2006-2015 should be to double the average increase to four percentage points.

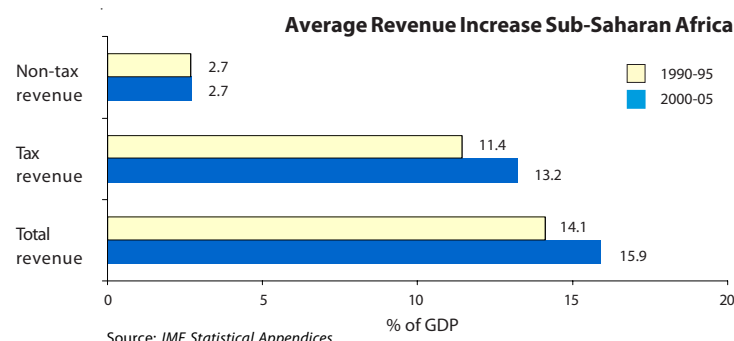
Even the modest increase achieved appears to be recouping an earlier loss of revenue. Total revenue for a representative sample of low-income countries in the early 1980s was 18-19 per cent of GDP. It dipped under 17 per cent in the 1990s and only recovered to 17-18 per cent in the early 2000s.

Recession or stagnant growth in many countries in the 1980s and 1990s is part of the explanation. The mistaken idea that governments in low-income countries were too big—and thus should be downsized—also partially explains the trend. And faulty tax advice from international financial institutions also played its part.

Governments had been advised to lower trade tariffs and institute, instead, a value added tax (VAT). They had also been advised to lower rates on direct taxes on personal income and corporate profits. As a result, trade taxes dropped markedly in sub-Saharan Africa from the early 1990s to the early 2000s, but the VAT recouped less than one third of the loss. Meanwhile, revenue from direct taxes languished.

Low-income countries in sub-Saharan Africa and elsewhere should adopt a more ambitious and diversified approach to revenue mobilisation if they hope to attain sizeable increases by 2015. Countries with a revenue/GDP ratio between 15 and 20 per cent should be supported to achieve the 20 per cent threshold. There are nine such countries in our sample of 26 (e.g., Benin, Cameroon and Malawi). Maximum efforts should focus on countries with a ratio lower than 15 per cent, assisting them to attain, at least, the minimal 15 per cent threshold. This applies to eleven countries in our sample (e.g., Burkina Faso, Mozambique and Tanzania).

The success of some countries in our sample (Ethiopia, Ghana, Mali, Mauritania, Rwanda and Uganda) in increasing their revenue/GDP



ratio by four percentage points or more provides useful lessons. A common pattern among them: they did not necessarily follow standard advice, such as downplaying direct taxes or trade taxes. Instead, they often relied on multiple sources.

Ethiopia was able to raise its revenue/GDP ratio from 12 to 16 per cent over 12 years from direct taxes on income, profits and land-use and from import duties. Mali relied on taxes on personal income, corporate profits, a domestic VAT and a VAT on imports to boost its revenue/GDP ratio from about 14 per cent in 1993 to about 18 per cent in 2004.

During 1994-2004, Mauritania's increases in fishing royalties and indirect taxes accounted for most of its sizeable revenue increase of about eight percentage points, and helped raise its revenue/GDP ratio to 26 per cent. But countries with rising revenue based on natural resources—such as Mauritania (fishing) and Sudan (oil)—still face a major challenge to diversify their revenue sources.

From a dismally low 7.2 per cent revenue/GDP ratio in 1991/2, Uganda boosted revenue by 5.4 percentage points by 2003/4. It introduced a VAT, maintained rates on personal and corporate income, eliminated exemptions and began taxing small businesses. Starting from a low 9.1 per cent, Rwanda increased its revenue by 4.5 percentage points of GDP in 10 years, primarily through income and profit taxes, a VAT and elimination of exemptions.

Ghana had an extraordinary record, raising revenue from about 12 per cent of GDP in 1990 to almost 24 per cent in 2004. Direct taxes on both personal income and corporate profits accounted for about four percentage points. Another five points came from domestic indirect taxes, i.e., a VAT (mostly on imports), a petroleum tax and even a levy for national health insurance. Import taxes brought in an additional two percentage points.

These success stories underscore the need for more MDG-inspired ambition on raising domestic revenue in low-income countries. A major focus of ODA should be, in fact, to build up national capacities for revenue mobilisation. With revenue/GDP ratios four percentage points higher by 2015, some countries could begin graduating from ODA to domestic resources as the driving force of development.

Note:

1. Invaluable research assistance provided by Magali Solimano is gratefully acknowledged.